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No. 06-484

IN THE

Supreme Court of the United States

TELLABS, INCORPORATED AND RICHARD NOTEBAERT,
Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF FOR THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, THE CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM, AND PROFESSORS JAMES D. COX, RICHARD M. BUXBAUM, JILL E. FISCH, C. HUGH FRIEDMAN, FRANK PARTNOY, MARC I. STEINBERG, AND MELVIN E. EISENBERG AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether the Private Securities Litigation Reform Act's requirement that to plead a claim of securities fraud plaintiff must state with particularity facts raising a "strong inference" that defendant acted with scienter changed long-established Rule 12(b)(6) jurisprudence that, in considering a motion to dismiss, the court must not only accept all well-pled facts, but must draw all reasonable inferences in plaintiff's favor to determine whether rational jurors could find from the collective allegations that the defendant acted with the required state of mind.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	v
INTEREST OF *AMICI CURIAE*	1
SUMMARY OF ARGUMENT	5
ARGUMENT	9
I. In Making a Rule 12(b)(6) Motion, a Defendant Necessarily Admits All Well-Pled Facts and Reasonable Inferences Drawn in Plaintiff's Favor, and Asserts Nonetheless that No Claim Is Stated	9
A. The PSLRA Does Not Address the Rule 12(b)(6) Practice that Inferences Are Drawn in Plaintiff's Favor, Which Under *Jones v. Bock* Can Only Be Changed by Amending the Rules	11
B. Under *Liberty Lobby*, The PSLRA "Strong Inference" Test for Pleading Scienter Does Not Change the Premise of Rule 12(b)(6) that Plaintiff Is Entitled to All Reasonable Inferences	14
C. A "Strong Inference" Is Defined by the Second Circuit to Mean Sufficient Facts Pleaded from Which a Jury Could Find "More-Likely-Than-Not" that Defendant Acted with Scienter	16
II. Contrary to Petitioners' Tally, Only the Sixth and Ninth Circuits Weigh Inferences Adverse to Plaintiffs; All Other Circuits Correctly Give Plaintiffs the Benefit of All Reasonable Inferences—as with Every Other Element of Fraud	18

TABLE OF CONTENTS—Continued

Page

III. Contrary to the SEC's Contentions, the PSLRA Does Not Require Courts to Consider Competing Inferences or Explanations; Doing So Would Violate the Right to Jury Trial 22

A. The Strong Inference Standard Does Not License Trial by Complaint 24

B. Applying *Liberty Lobby* by Drawing All Reasonable Inferences in Plaintiffs' Favor Avoids Intrusion on the Right to Jury Trial .. 26

IV. This Court Should Reaffirm the Majority Rule that Plaintiff Is Entitled to All Reasonable Inferences Tested as a Totality Against the "Strong Inference" Standard; Allowing Inferences Adverse to Plaintiff Violates Rule 12(b)(6), and Would Seriously Impair Investor Recovery for Corporate Fraud 28

CONCLUSION 30

TABLE OF AUTHORITIES

CASES — Page

ABC Arbitrage Plaintiffs Group v. Tchuruk, 291 F.3d 336 (5th Cir. 2002) 6, 29
Abrams v. Baker-Hughes, Inc., 292 F.3d 424 (5th Cir. 2002) 17
Adams v. Kinder-Morgan, Inc., 340 F.3d 1083 (10th Cir. 2003) 11, 15, 29
Aldridge v. A.T. Cross Corp., 284 F.3d 72 (1st Cir. 2002) 8, 21
American Federation v. American Intern., 462 F.3d 121 (2d Cir. 2006) 24
Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986) ..... *passim*
Bourjaily v. United States, 483 U.S. 171 (1987) ... 17-18
Bryant v. Avado Brands, Inc., 187 F.3d 1271 (11th Cir. 1999) 25
City of Monroe Employees v. Bridgestone, 399 F.3d 651 (6th Cir. 2005) 17, 19
Cohen v. Koenig, 25 F.3d 1168 (2d Cir. 1994) ... 8, 17, 24
Conley v. Gibson, 355 U.S. 41 (1957) 9, 10
Cosmas v. Hassett, 886 F.2d 8 (2d Cir. 1989) 17
Desert Palace, Inc. v. Costa, 539 U.S. 90 (2003) ... 10
Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451 (1992) 26
Ex Parte Peterson, 253 U.S. 300 (1920) 27-28
Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645 (8th Cir. 2001) 7, 15, 21
Galloway v. United States, 319 U.S. 372 (1943) ... 28
Garfield v. NDC Health Corp., 466 F.3d 1255 (11th Cir. 2006) 21
Gompper v. VISX, Inc., 298 F.3d 893 (9th Cir. 2002) 18-20
Helwig v. Vencor, Inc., 251 F.3d 540 (6th Cir. 2001) 18-19

TABLE OF AUTHORITIES—Continued

Page

Herman & MacLean v. Huddleston, 459 U.S. 375 (1983)..... 8, 10, 16, 29-30
Hill v. McDonough, 547 U.S. __, 126 S. Ct. 2096 (2006)..... 12
Hishon v. King & Spaulding, 467 U.S. 69 (1984)... 15
Illinois v. Gates, 462 U.S. 213 (1983)..... 26
In re Cabletron Systems Inc., 311 F.3d 11 (1st Cir. 2002)..... *passim*
In re Cavanaugh, 306 F.3d 726 (9th Cir. 2002).... 13
In re Cendant Corp. Lit., 264 F.3d 201 (3d Cir. 2001)..... 13
In re Credit Suisse First Boston Corp., 431 F.3d 36 (1st Cir. 2005)..... 20-21
In re K-Tel Intern, Inc. Sec. Litig., 300 F.3d 881 (8th Cir. 2002) 21
In re PEC Solutions, Inc. Sec. Lit., 418 F.3d 379 (4th Cir. 2005) 22
In re Rockefeller Center Properties, Inc. Sec. Litig., 311 F.3d 198 (3d Cir. 2002).....8, 17, 21
In re Stone & Webster Sec. Lit., 414 F.3d 187 (1st Cir. 2005)..... 20
Int'l Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979) 24
Jones v. Bock, __ U.S. __, 127 S. Ct. 910 (2007)..... 5, 11-12, 24
Lampf v. Gilbertson, 501 U.S. 350 (1991) 7
Leatherman v. Tarrant County, 507 U.S. 163 (1993)..... 10, 12
Lee v. City of Los Angeles, 250 F.3d 668 (9th Cir. 2001)..... 25
Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574 (1986) 25-26
Miles v. Apex Marine Corp., 498 U.S. 19 (1990).. 11, 17

TABLE OF AUTHORITIES—Continued

Page

Nathenson v. Zonagen, Inc., 267 F.3d 400 (5th Cir. 2001) 21
Neitzke v. Williams, 490 U.S. 319 (1989) 10
Newby v. Enron Corp. (In re Enron Corp. Sec. Litig.), 206 F.R.D. 427 (S.D. Tex. 2002) 1
Novak v. Kasaks, 216 F.3d 300 (2d Cir. 2000) .. 13-14, 24
Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 383 (5th Cir. 2003) 22
Papasan v. Allain, 478 U.S. 265 (1986) 10, 14
Parklane Hosiery Co. v. Shore, 439 U.S. 322 (1979) 27
Pawling v. United States, 8 U.S. [4 Cranch] 219, 221-22 (1808) 5, 9-10, 27
Pirraglia v. Novell, 339 F.3d 1182 (10th Cir. 2003) 8, 15, 18, 21-22
Reeves v. Sanderson Plumbing Products, Inc., 530 U.S. 133 (2000) 6, 15-16, 28
Rombach v. Chang, 355 F.3d 164 (2d Cir. 2004) 12, 23, 24
Ronconi v. Larkin, 253 F.3d 423 (9th Cir. 2001) .. 7
Scheuer v. Rhodes, 416 U.S. 232 (1974) 5, 9
Shields v. Citytrust Bankcorp., 25 F.3d 1124 (2d Cir. 1994) 12, 23
Suez Equity Investors L.P. v. Toronto-Dominion Bank, 250 F.3d 87 (2d Cir. 2001) 21
Swierkiewicz v. Sorema N.A., 534 U.S. 506 (2002) 10, 12
United States v. Malouf, 466 F.3d 21 (1st Cir. 2006) 21

STATUTES, RULES AND REGULATIONS

15 U.S.C.
§78u-4(a) 12, 30

TABLE OF AUTHORITIES—Continued

Page

§78u-4(b) ..... *passim*
§78z 25

Federal Rules Civil Procedure

Rule 8 10
Rule 12(b)(6) ..... *passim*

SECONDARY AUTHORITIES

H.R. Conf. Rep. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730 ..... 8, 13, 30
James D. Cox & Randall S. Thomas, "Does the Plaintiff Matter?" 106 Colum. L. Rev. 1587, 1631 (2006) 13
S. Rep. No. 104-98, at 15 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 694 11
The Economist, *Classier actions* (Feb. 15, 2007) 4, 7, 13
Wright & Miller, *Fed. Prac. & Proc. Civil 3d*, Vol. 5B, §1357 at 417 9

INTEREST OF *AMICI CURIAE* [1]

The Regents of the University of California ("The Regents"), and the California Public Employees Retirement System ("CalPERS"), are institutional investors in publicly traded securities that have a strong interest in ensuring the integrity and transparency of U.S. securities markets. Their experience as lead plaintiff in securities class actions will assist the Court in evaluating the policy implications of its decision. Professors James D. Cox, Richard M. Buxbaum, Jill E. Fisch, C. Hugh Friedman, Frank Partnoy, Marc I. Steinberg, and Melvin E. Eisenberg, are corporate, securities and civil procedure law specialists with strong interests in ensuring that U.S. securities laws and procedures are consistently and fairly applied to protect investors from fraudulent practices. A brief description of each of the *amici* follows:

1. Article IX, section 9 of the California Constitution grants The Regents "full powers of organization and government" over the University of California. As fiduciary for the University's pension and endowment funds for nearly 500,000 active and retired participants, The Regents' assets of $66 billion include substantial investments in publicly traded securities. In 2002, The Regents were appointed lead plaintiff in the class suit involving Enron Corporation. *Newby v. Enron Corp.* (*In re Enron Corp. Sec. Litig.*), 206 F.R.D. 427 (S.D. Tex. 2002).

2. CalPERS is the largest public pension plan in the United States. It provides retirement and health benefits to 1.5 million public employees, retirees and their families.

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[1] This brief was not authored, in whole or in part, by counsel for either party, and no person or entity other than *amici*, their members and their counsel contributed monetarily to the submission of the brief. The parties' general letters of consent to the filing of *amicus* briefs have been filed with the clerk. Prior to May 2004, certain partners in the firm representing *amici* were partners in the firm representing respondents when this action was initiated, but neither they nor their firm have any economic interest in the outcome of this litigation.

CalPERS is the fiduciary for the California state employee pension fund, with some $223 billion in assets, including substantial investment in publicly traded U.S. securities. CalPERS has served as lead plaintiff representing classes of investors in several cases, as follows: *In re Cendant Corp. Sec. Litig.*, No. 98 Civ. 1664-WHW (D.N.J.); *California Public Employees' Retirement System v. Chubb Corp.*, No. 00 Civ. 4285-GEB (D.N.J.); *In re NYSE Specialist Sec. Litig.*, No. 03-Civ. 8264-RWS (S.D.N.Y.); *California Public Employees' Retirement System v. United Health Group, Inc.*, No. 06 Civ. 2939-JMR/FLN (D. Minn.).

3. Professor James D. Cox joined the faculty of the School of Law at Duke University in 1979 where he specializes in corporate and securities law. Professor Cox earned his law degree at the University of California, Hastings College of the Law (J.D.) and Harvard Law School (LL. M.). In addition to his texts *Cox and Hazen on Corporations*; and *Securities Regulations Cases and Materials* (with Professors Hillman & Langevoort), Professor Cox has published extensively in the areas of market regulation and corporate governance as well as having testified before Congress on insider trading and market reform issues. He is a former member of the New York Stock Exchange ("NYSE") Legal Advisory Committee and a member of the National Association of Securities Dealers ("NASD") Legal Advisory Board.

4. Professor Richard M. Buxbaum received his law degrees from Cornell Law School (LL.B. 1952) and the University of California, Boalt Hall School of Law (LL.M. 1953). After practicing law for eight years, he joined the Boalt faculty in 1961. He publishes and teaches in the fields of corporate law and international economic law. Professor Buxbaum has served on various state and national committees engaged in the drafting of securities legislation.

5. Professor Jill E. Fisch is a Visiting Professor at the University of Pennsylvania Law School and T.J. Maloney

Professor of Business Law at Fordham University. In 1989, after obtaining her J.D. from Yale Law School, and three years with the Justice Department and the Cleary Gottlieb firm, respectively, Professor Fisch joined the Fordham faculty where she serves as Director of the Fordham Center for Corporate, Securities and Financial Law. Professor Fisch teaches corporations, securities regulation and federal courts. She is chair-elect of the Section on Securities Regulation of the Association of American Law Schools. Professor Fisch's scholarship includes work on corporate law, securities regulation, and federal courts, that have appeared in a variety of publications including the *Harvard*, *Columbia* and *Cornell Law Reviews*, and the *Yale Law Journal*. (*E.g.*, Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction, 102 *Colum. L. Rev.* 650 (2002).

6. Professor C. Hugh Friedman received his law degree in 1956 from Stanford University and is a Senior Professor of Corporation and Securities Law at the University of San Diego School of Law, where he has practiced, taught and written about corporation and securities law for 40 years. Among his publications is the widely used two-volume *California Practice Guide: Corporations* (The Rutter Group). He chaired the California Securities Regulation Regulatory Reform Commission.

7. Professor Frank Partnoy has been Professor of Law at the University of San Diego School of Law since 1997. He received his J.D. in 1992 from Yale University. Professor Partnoy teaches and writes in the areas of corporate law and financial market regulation. His publications include *Infectious Greed: How Deceit and Risk Corrupted the Financial Markets* (Henry Holt), and more than 20 articles on various topics related to financial market regulation.

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1982. Professor Steinberg teaches courses in Securities Regulation, Securities Litigation, and Business Enterprises. From 1978 to 1982, he was an attorney with the U.S. Securities and Exchange Commission ("SEC"). He has authored approximately 125 law journal articles and several books, including *Securities Regulation*, a law school textbook.

9. Melvin A. Eisenberg is Koret Professor of Law at the University of California, Boalt Hall School of Law. He received his law degree from Harvard in 1959. After practicing with the Kaye Scholer firm in New York, and serving as assistant counsel to the Warren Commission, he joined the Boalt Faculty in 1966. Professor Eisenberg is the author of *The Structure of the Corporation* (1997) and has published casebooks on the subjects of contracts and corporations. He was chief reporter for the American Law Institute's *Principles of Corporate Governance*.

The issue in this case concerns the interpretation of the Private Securities Litigation Reform Act ("PSLRA") "strong inference" pleading standard. If that standard is interpreted to change the usual practice under Federal Rule of Civil Procedure 12(b)(6) that courts draw all reasonable inferences from the complaint in plaintiff's favor, to allow the weighing of competing inferences and explanations, it could seriously impair the ability of hundreds of thousands of middle class employees, retirees, and their families, whom the institutional *amici* represent, to recover devastating losses caused by fraud.

Meritorious private actions, including those brought by institutions, are an essential component of the enforcement of the securities laws. Indeed, the PSLRA was designed to encourage institutional investors to serve as lead plaintiffs in securities class actions as an important means of ensuring meritorious suits and eliminating non-meritorious ones. Recent studies confirm that the increased role of institutional investors as lead plaintiffs has resulted in fewer and better securities suits. The Economist, *Classier actions* (Feb. 15, 2007).

SUMMARY OF ARGUMENT

In making a Rule 12(b)(6) motion to dismiss, defendants necessarily admit all well-pled allegations and all inferences a jury can reasonably draw in plaintiff's favor, and assert nonetheless that no claim for relief is stated. These basic assumptions are 200 years old. As Chief Justice Marshall explained: "The party demurring admits the truth of the testimony to which he demurs and also those conclusions of fact which a jury may fairly draw from the testimony." *Pawling v. United States*, 8 U.S. [4 Cranch] 219, 221-22 (1808). Thus, a Rule 12(b)(6) motion tests plaintiff's best case to determine whether—as a matter of law—he states a claim. *Scheuer v. Rhodes,* 416 U.S. 232, 236 (1974). The court does not sit as a fact finder to weigh defendants' explanations.

Neither petitioners nor any of their *amici* save one even mention Rule 12(b)(6). They doubtless prefer that this Court disregard it. Instead, they rely entirely on the PSLRA. But, in enacting the PSLRA, Congress did not address, let alone amend the essential premises of Rule 12(b)(6). Congress simply provided that to state a claim for securities fraud, the "complaint" must "state with particularity" facts giving rise to a "strong inference that the defendant acted with the requisite state of mind." 15 U.S.C. §78u-4(b)(2). The PSLRA did not empower courts to draw inferences adverse to plaintiff or weigh competing explanations. Any such change in the "usual practice under the Federal Rules" must be obtained by amending the Rules, "not by judicial interpretation." *Jones v. Bock*, __ U.S. __, 127 S. Ct. 910, *25 (2007).

Further, this Court's decision in *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986) explains why the PSLRA's heightened "strong inference" standard is not inconsistent with the inference-drawing assumptions of Rule 12(b)(6). On a dispositive motion, the court views the facts "through the prism of the substantive evidentiary burden" (*Id.* at 254), but:

> Credibility determinations, the weighing of evidence, and the drawing of legitimate inferences from the facts

> are jury functions, not those of a judge, whether he is ruling on a motion for summary judgment or for a directed verdict. The evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor.

Id. at 256; *accord Reeves v. Sanderson Plumbing Products, Inc.*, 530 U.S. 133, 150-52 (2000).

Liberty Lobby also makes clear that a judge's determination of a dispositive motion "unavoidably asks whether reasonable jurors could find by a preponderance of the evidence" for the plaintiff. *Id.* at 252. In this case, the Seventh Circuit correctly applied a test that is mandated by *Liberty Lobby*. The Seventh Circuit held that the pleadings are to be judged by whether "a reasonable person could infer that the defendant acted with the required intent." (App. 20a) Thus, contrary to petitioners and their *amici*, the Seventh Circuit did not ignore the PSLRA "strong inference" standard or dilute it to a reasonable inference; it simply applied this Court's "reasonable jurors" approach from *Liberty Lobby*.

In light of its evident relevance here, it is startling that neither petitioners nor the SEC even cite *Liberty Lobby*. Two of petitioners' *amici* (Washington Legal Foundation and American Institute of Certified Public Accountants) do cite it, but only for the proposition that an elevated standard may apply to dispositive motions (WLF Br. 17, 20 n.9, AICPA Br. 18). These *amici* ignore *Liberty Lobby's* holding that plaintiffs are still entitled to "all justifiable inferences."

The PSLRA "was not enacted to raise the pleading burdens" to a level that "facially valid claims" must be "routinely dismissed." *ABC Arbitrage Plaintiffs Group v. Tchuruk*, 291 F.3d 336, 354 (5th Cir. 2002). The PSLRA contains ample safeguards to achieve its goal of curbing pleading abuse without rewriting long-established Rule 12(b)(6) jurisprudence. In addition to the "***strong inference***" standard, the statute requires that falsity and scienter be alleged with "***particularity***," and that plaintiff plead with particularity a

factual basis for information and belief allegations from witness or document sources. 15 U.S.C. §78u-4(b)(1), (2).

Petitioners and their *amici* overlook that, since 1995, securities litigation has been taken over by respected institutional investors, such as the *amici* on this brief, who meet the lead plaintiff qualifications of the PSLRA. 15 U.S.C. 78u-4(a)(3)(B). The parade of horribles petitioners portray ignores the reality that there are fewer class actions today, and they are better led and better pled. The Economist, *Classier actions* (Feb. 15, 2007).

"Given the complexity of modern securities markets," pleading and proving the elements of a §10(b) claim "may be difficult." *Lampf v. Gilbertson*, 501 U.S. 350, 377 (1991) (Kennedy, J. dissenting). Because private §10(b) actions are "an essential component of the protection the law gives to investors who have been injured by unlawful practices" (*Id.* at 374), raising the bar even higher than provided in the PSLRA "will 'thwart the legislative purpose of creating an effective remedy' for victims of securities fraud." *Id.* at 377. "Unless reasonable inferences from circumstances suffice to get a case to a jury, the welfare of victimized investors and the integrity of the stock market may be insufficiently protected from deceptive manipulators." *Ronconi v. Larkin*, 253 F.3d 423, 428 (9th Cir. 2001).

Though plaintiff's underlying inferences must be reasonable, only the ultimate inference of scienter, based on the "totality" of facts and justifiable inferences drawn, must "collectively add up to a strong inference." *See, e.g., Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 660 (8th Cir. 2001); *In re Cabletron Systems Inc.*, 311 F.3d 11, 42 (1st Cir. 2002). In offering definitions of "strong inference," however, petitioners and their *amici* aggressively push to elevate the standard even further suggesting that plaintiff's allegations must be "compelling" and "leave little room for doubt" and even "exclude the possibility of inno-

cence." (Pet. Br. 25, 34) They ignore the Second Circuit jurisprudence, which created the "strong inference" standard, and defined it to mean sufficient facts pled from which a jury could find "more likely than not" that defendant acted with scienter. *Cohen v. Koenig*, 25 F.3d 1168, 1174 (2d Cir. 1994). That definition is consistent with this Court's "preponderance of evidence" standard for securities cases. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 (1983). Neither petitioners nor the SEC mention *Huddleston* either.

Further, contrary to petitioners' count (Petition 4, 17), only the Sixth and Ninth Circuits hold that the PSLRA permits courts to weigh inferences adverse to plaintiffs. All other circuits, including the Seventh Circuit here (App. 7a, 20a-21a), continue to recognize that under Rule 12(b)(6) plaintiffs are entitled to all reasonable inferences, provided the facts are alleged with particularity. *See, e.g., In re Rockefeller Center Properties, Inc. Sec. Litig.*, 311 F.3d 198, 224 (3d Cir. 2002); *Pirraglia v. Novell*, 339 F.3d 1182, 1188 (10th Cir. 2003). More specifically, the First Circuit held it was error under Rule 12(b)(6) to draw "inferences in the defendant's favor." *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 79 (1st Cir. 2002).

In sum, petitioners' theory that inferences adverse to plaintiff may be drawn should be rejected. It not only violates Rule 12(b)(6), but would impair private securities litigation as "an indispensable tool with which defrauded investors can recover their losses without having to rely on government action" which Congress retained in enacting the PSLRA. H.R. Conf. Rep. 104-369, at *31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730; *Huddleston*, 459 U.S. at 390 (defrauded investors are "the very individuals Congress sought to protect").

ARGUMENT

I. In Making a Rule 12(b)(6) Motion, a Defendant Necessarily Admits All Well-Pled Facts and Reasonable Inferences Drawn in Plaintiff's Favor, and Asserts Nonetheless that No Claim Is Stated

The jurisprudential basis of a Rule 12(b)(6) motion to dismiss a complaint for failure to state a claim does not permit the drawing of adverse inferences. By filing such a motion, defendants convey to the court the message that: even if it accepts all well-pled facts as true, and draws all reasonable inferences "in the light most favorable to the plaintiff," as a matter of law, plaintiffs are not entitled to relief. *See* Wright & Miller, *Fed. Prac. & Proc. Civil 3d*, Vol. 5B, §1357 at 417. There is no room in that process for weighing against plaintiff potential conflicting inferences or explanations asserted by defendants. The court considers plaintiff's best case—not defendant's most plausible defense. Such weighing of disputed inferences is for the jury.

Since the adoption of Rule 12 in 1937, all federal courts have uniformly adhered to the rule that on a motion to dismiss, all facts and reasonable inferences are construed in plaintiff's favor. In *Conley v. Gibson*, 355 U.S. 41 (1957), this Court reaffirmed that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Id.* at 45-46. In passing on a motion to dismiss for failure to state a claim, "the allegations of the complaint should be construed favorably to the pleader." *Scheuer*, 416 U.S. at 236.

These principles can be traced back nearly 200 years. In 1808, Chief Justice Marshall stated: "***The party demurring admits*** the truth of the testimony to which he demurs and also ***those conclusions of fact which a jury may fairly draw*** from that testimony. Forced and violent inferences he does not admit; but the testimony is to be taken most strongly against him, ***and such conclusions as a jury might justifiably draw***

the court ought to draw." *Pawling*, 8 U.S. [4 Cranch] at 221-22 (emphasis added).

This Court has acknowledged the importance of inference-drawing in a securities fraud action: "proof of scienter required in fraud cases is often a matter of inference from circumstantial evidence." *Huddleston*, 459 U.S. at 387-90 & n.30 (holding that plaintiff must prove fraud only by a preponderance of the evidence). "'Circumstantial evidence is not only sufficient but may also be more certain, satisfying and persuasive than direct evidence.'" *Desert Palace, Inc. v. Costa*, 539 U.S. 90, 100 (2003) (citation omitted).

To guard against pleading abuses, however, this Court made it clear that courts "are not bound to accept as true a legal conclusion couched as a factual allegation." *Papasan v. Allain*, 478 U.S. 265, 286 (1986). The Securities Industry group, the only *amici* to even mention Rule 12(b)(6), assert that "courts need not accept the truthfulness of allegations that are merely conclusions, characterizations, or inferences." (Sec. Ind. Br. 20 & n.3) But their assertion omits the crucial word "***unwarranted***" from all of the cases they cite. The omission is significant. All courts hold that judges must accept reasonable inferences warranted by well-pled facts. Indeed, as this Court made clear, "What Rule 12(b)(6) does not countenance are dismissals based on a judge's disbelief of a complaint's factual allegations." *Neitzke v. Williams*, 490 U.S. 319, 327 (1989). Well-pled factual allegations must be accepted "as true" and construed in plaintiff's favor. *Leatherman v. Tarrant County*, 507 U.S. 163, 164 (1993); *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 508 n.1 (2002).

Petitioners and the SEC incorrectly treat Fed. R. Civ. P. 8 as the source of the inference-drawing rule, but in doing so fail to cite Rule 12(b)(6). (Pet. Br. 15, 21; SEC Br. 11-12) They cite *Conley* only for this Court's holding that under Rule 8 a plaintiff is not required to "detail the facts upon which he bases a claim" (355 U.S. at 47), but they ignore the separate holding of *Conley* that the adequacy of the complaint

on a Rule 12(b)(6) motion is judged by the ***best*** case plaintiff can plead. *Id.* at 45-46.

A. The PSLRA Does Not Address the Rule 12(b)(6) Practice that Inferences Are Drawn in Plaintiff's Favor, Which Under *Jones v. Bock* Can Only Be Changed by Amending the Rules

Petitioners' assertion that courts may consider inferences adverse to plaintiffs is not justified by any language in the PSLRA. The statute simply provides that in pleading fraud, plaintiff's "complaint" must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. §78u-4(b)(2). But as *Liberty Lobby* explained, a higher "strong inference" standard does not alter the civil rules. This Court assumes that Congress is "aware of existing law when it passes legislation." *Miles v. Apex Marine Corp.*, 498 U.S. 19, 32 (1990). Because the PSLRA says nothing about amending Rule 12(b)(6), it did not disturb bedrock jurisprudence requiring that reasonable inferences arising from complaint allegations be drawn in plaintiff's favor, and does not empower courts to draw inferences adverse to plaintiffs.

The plain language of the statute provides that "the complaint shall . . . state with particularity facts giving rise to a strong inference" of scienter. The statute and its legislative history says nothing about drawing or weighing adverse inferences. 15 U.S.C. §78u-4(b). Further, the Senate Committee stated that in adopting the "strong inference" standard: "The Committee does not adopt a new and untested pleading standard that would generate additional litigation." S. Rep. No. 104-98, at 15 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 694. "The PSLRA did not . . . purport to move up the trial to the pleadings stage." *Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1101 (10th Cir. 2003). To accept the petitioners' theory would supplant the function of a trial.

Prior to the PSLRA, the "strong inference" standard had long been in use in the Second Circuit. *Shields v. Citytrust Bankcorp.*, 25 F.3d 1124, 1128 (2d Cir. 1994). That circuit, both before and since the PSLRA, adhered to the jurisprudential premise of Rule 12(b)(6) that "all reasonable inferences [are drawn] in plaintiff's favor" to assess whether the best case that he can plead meets the strong inference standard. *Rombach v. Chang*, 355 F.3d 164, 169 (2d Cir. 2004).

In January 2007, this Court unanimously held that "courts should generally not depart from the usual practice under the Federal Rules," except "by the process of amending the Federal Rules, and not by judicial interpretation." *Jones*, 127 S. Ct. 910 at *25; quoting *Leatherman*, 507 U.S. at 168; *accord Swierkiewicz*, 534 U.S. at 515; *Hill v. McDonough*, 547 U.S. __, 126 S. Ct. 2096, 2103 (2006). Although, unlike the statute in *Jones*, the PSLRA does require plaintiff to plead a "strong inference" with particularity, the PSLRA nowhere provides that courts can consider and weigh adverse inferences or competing explanations in determining a Rule 12(b)(6) motion. Under *Jones*, imposing such a "different and more onerous" inference-drawing regime "to deal with particular categories of cases should be done through established rule making procedures, and not on a case-by-case basis by the courts." *Jones*, 127 S. Ct. at *45-*46.

Petitioners and their *amici*, including the SEC, dwell on alleged pleading abuses as if they still exist. They totally ignore that as a result of the enactment of the PSLRA, securities class actions are better led and better pled due to the increasing role of large public pension fund fiduciaries—including *amici* on this brief—acting as institutional "lead plaintiffs." Such institutional plaintiffs provide responsible vigorous supervision of the litigation, precisely as Congress intended in enacting the lead plaintiff provision of the PSLRA. 15 U.S.C. §78u-4(a)(3)(B)(iii)(I)(bb). By creating a presumption that the "most adequate" candidate for lead plaintiff is the person or group that "has the largest financial

interest in the relief sought by the class," Congress intended to attract institutional investors to that role and specifically said as much in the legislative history. "The Conference Committee believes that increasing the role of institutional investors—[including public "pension funds" representing "small investors"]—in class actions will ultimately benefit shareholders and assist courts by improving the quality of representation in securities class actions." H.R. Conf. Rep. 104-369 (1995), at *34, *reprinted in* 1995 U.S.C.C.A.N. 730, 733; *see In re Cendant Corp. Lit.*, 264 F.3d 201, 261, 264 (3d Cir. 2001); *accord In re Cavanaugh*, 306 F.3d 726, 738 (9th Cir. 2002).

Thus, it is both obsolete and wrong for petitioners, their industry *amici*, and also the SEC, to seek further judicially-created restrictions on private securities actions. Pension funds like *amici* here are experienced fiduciaries, governed by respected boards and advised by independent fund counsel, not simply by securities litigation counsel. They are not "lawyer-driven" or "professional plaintiffs" filing sham suits. Today, "shareholder class actions are fewer in number," but "better led" by pension funds and other institutional investors. The Economist, *Classier actions* (Feb. 15, 2007). There is empirical support for this. *See* James D. Cox & Randall S. Thomas, "Does the Plaintiff Matter?" 106 *Colum. L. Rev. 1587*, 1631 (2006). Institutional lead plaintiffs increase recoveries by statistically significant amounts.

In addition to the role of institutional plaintiffs, the PSLRA contains ample procedural safeguards to prevent sham conclusory pleading and the statute has been successful in doing so. The statute's "***strong inference***" and "***particularity***" requirements provide the principal protections. 15 U.S.C. §78u-4(b)(2). Further protection is provided by the PSLRA requirement that plaintiff plead a specific ***factual basis*** for allegations made on information and belief from witness and document sources. 15 U.S.C. §78u-4(b)(1); *Cabletron*, 311 F.3d at 28-33 (1st Cir. 2002); *Novak v. Kasaks*, 216 F.3d

300, 314 (2d Cir. 2000). Another is the court's ability to reject inferences in plaintiff's favor when they are unreasonable or unwarranted by the facts alleged. *Papasan*, 478 U.S. at 286. In light of these protections, the long-established analysis under Rule 12(b)(6) that focuses on the sufficiency of allegations and inferences construed in plaintiff's favor, viewed collectively, without competing explanations, does not thwart Congress' basic purpose in the PSLRA. Congress wanted to limit abusive, vague suits—not careful, measured actions of substance.

B. Under *Liberty Lobby*, The PSLRA "Strong Inference" Test for Pleading Scienter Does Not Change the Premise of Rule 12(b)(6) that Plaintiff Is Entitled to All Reasonable Inferences

This Court has held that in ruling on a dispositive motion as to a claim with an elevated standard of proof, though the court must view the facts "through the prism of the substantive evidentiary burden," still "[t]he evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor." *Liberty Lobby*, 477 U.S. at 254-56. This Court explained that its "holding that the clear-and-convincing standard of proof should be taken into account in ruling on summary judgment motions does not denigrate the role of the jury." *Id.* at 255. The Court reaffirmed that "the weighing of the evidence, and the draw-ing of legitimate inferences from the facts are jury functions." *Id.*

Although *Liberty Lobby* arose on summary judgment, the same reasoning applies with even greater force on a Rule 12(b)(6) motion because at that pretrial stage the court is precluded from even considering evidence—let alone resolving evidentiary disputes. The whole point of Rule 12(b)(6) is to assess plaintiff's ***best*** case—without competing explanations or possible adverse inferences—to determine whether "relief could be granted under any set of facts that could be

proved consistent with the allegations." *Hishon v. King & Spaulding*, 467 U.S. 69, 73 (1984).

Petitioners and the SEC totally overlook *Liberty Lobby*. They incorrectly assert that the Seventh Circuit erred in applying a "could infer" approach that somehow "diluted" the strong inference standard to mean only a reasonable inference. (SEC Br. 23) The SEC confuses "the relative strength of the inference required" with "the nature of the person drawing [it]." (*Id.* 23 n.7) Whether a rational juror "could infer" a strong inference of scienter from the totality of facts and inferences pled, viewed in plaintiff's favor, is precisely what *Liberty Lobby* and Rule 12(b)(6) require. As framed by this Court, when addressing a dispositive motion, "[t]he judge's inquiry, therefore, ***unavoidably asks*** whether reasonable jurors ***could find*** by a preponderance of the evidence"—here the facts alleged—"that the plaintiff is entitled to a verdict." *Liberty Lobby*, 477 U.S. at 252 (emphasis added).

In *Reeves*, 530 U.S. at 150, this Court applied *Liberty Lobby* in the context of a motion for judgment as a matter of law. This Court held that though a court reviews all of the evidence presented at trial, it "must draw all reasonable inferences in favor of the nonmoving party" and "***must disregard all evidence favorable to the moving party that the jury is not required to believe***." *Reeves*, at 150-51 (emphasis added). *Reeves* further held that the court impermissibly substitutes its judgment for that of the jury when it fails "to draw all inferences in favor of [nonmovant]." *Id.* at 152. These principles plainly apply on a Rule 12(b)(6) motion. When a court is "[f]aced with two seemingly equally strong inferences" at the pleading stage, one favoring plaintiff and one not, resolution is for the fact finder. *Pirraglia*, 339 F.3d at 1188. "The strong-inference pleading standard does not license us to resolve disputed facts at this stage of the case." *Green Tree*, 270 F.3d at 666. The PSLRA did not enact trial by complaint. *Adams*, 340 F.3d at 1101.

Thus, the Seventh Circuit's "could infer" approach is consistent with *Liberty Lobby*, *Reeves*, Rule 12(b)(6), and the PSLRA. It does not dilute the strong inference standard—it correctly applied it. Nowhere in its opinion does the Seventh Circuit equate a strong inference to one that is merely reasonable. The court simply concluded that reasonable inferences considered collectively, must add up to a strong inference. "'We []understand a "strong inference" of scienter to be a conclusion logically based upon particular facts that would convince a reasonable person that the defendant knew a statement was false or misleading.'" (App. 21a).

C. A "Strong Inference" Is Defined by the Second Circuit to Mean Sufficient Facts Pleaded from Which a Jury Could Find "More-Likely-Than-Not" that Defendant Acted with Scienter

Petitioners define a "strong inference as one that is "compelling," and "meaningfully tends to exclude the possibility of innocence" and leaves "little room for doubt." (Pet. Br. 25, 34 n.15) The SEC suggests a "high likelihood" standard. (SEC Br. 20-21) Such definitions would import a clear-and-convincing evidence or even a beyond-a-reasonable-doubt hurdle as hinted at by petitioners' "exclude . . . innocence" and "little room for doubt" rubrics (Pet. Br. 34), that are wrong under *Huddleston*. There, this Court rejected a clear-and-convincing test in securities cases and set a "preponderance-of-the-evidence" standard that is untouched by the PSLRA. *Huddleston*, 459 U.S. at 390. Nothing in the PSLRA suggests that Congress intended to impose a pleading standard that is so dramatically more demanding than the burden of proof at trial. In *Liberty Lobby*, this Court held that the standard at trial should also apply to a dispositive motion. 477 U.S. at 254-55.

The petitioners and the SEC never mention that the Second Circuit not only coined the term "strong inference," but also defined it. A strong inference of scienter is alleged when

"sufficient facts were pleaded to suggest that plaintiffs may be able to prove that defendants ***more likely than not*** knew their financial representations were false." *Cohen*, 25 F.3d at 1174 (emphasis added). This definition, articulated in the year before enactment of the PSLRA, was presumably known to Congress when it adopted the strong inference standard. *Miles*, 498 U.S. at 32.

The Second Circuit definition is consistent with the preponderance of evidence standard of *Huddleston*, and with this Court's explanation in *Liberty Lobby* that in ruling on a dispositive motion "through the prism" of any heightened standard, the judge "unavoidably asks whether reasonable jurors could find ***by a preponderance of the evidence***" that plaintiff is entitled to a verdict—here on the issue of scienter. *Liberty Lobby*, 477 U.S. at 252, 254 (emphasis added).

Further, the Second Circuit analysis required that only the ultimate inference of scienter—drawn from the facts alleged and inferences drawn viewed collectively—must be strong; the underlying component inferences need simply be reasonable ones. *Cosmas v. Hassett*, 886 F.2d 8, 11, 13 (2d Cir. 1989) (holding that underlying facts and reasonable inferences collectively gave rise to a strong inference, reading the complaint in plaintiff's favor). All circuits agree that the court must consider the ***totality*** of well-pled allegations and inferences drawn in plaintiff's favor. *See, e.g., Abrams v. Baker-Hughes, Inc.*, 292 F.3d 424, 430-31 (5th Cir. 2002) ("allegations should not be read in isolation, but taken together as a whole to see if they raise the necessary strong inference of scienter"); *City of Monroe Employees v. Bridgestone*, 399 F.3d 651, 683 (6th Cir. 2005) (the judges "employ a totality of circumstances analysis whereby the facts argued collectively must give rise to a strong inference."); *see Rockefeller*, 311 F.3d at 224-25 (allegations are not viewed as a totality unless they are stated with particularity).

This Court has itself emphasized the importance of viewing facts collectively and not in isolation. *Bourjaily v. United*

States, 483 U.S. 171, 179 (1987). As then Chief Justice Rehnquist explained, "individual pieces of evidence, insufficient in themselves to prove a point, may in cumulation prove it. The sum of an evidentiary presentation may well be greater than its constituent parts." *Id.* at 179-80.

In sum, evaluating motions to dismiss under the PSLRA is no different than any other Rule 12(b)(6) motion. Whether the complaint meets the "strong inference" standard can be determined consistently with Rule 12(b)(6) without doing violence to the Rule's premise that plaintiff is entitled to all justifiable inferences by analyzing the best case he can plead, as a totality, against the heightened standard.

II. Contrary to Petitioners' Tally, Only the Sixth and Ninth Circuits Weigh Inferences Adverse to Plaintiffs; All Other Circuits Correctly Give Plaintiffs the Benefit of All Reasonable Inferences—as with Every Other Element of Fraud

Contrary to petitioners' assertion that four or more circuits allow adverse inferences (Pet. 4), only two circuits, the Sixth and Ninth, have held that the PSLRA's "strong inference" standard allows district courts to consider and weigh adverse inferences in assessing scienter pleading. *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001) (*en banc*); *Gompper v. VISX, Inc.*, 298 F.3d 893, 896-97 (9th Cir. 2002). All other circuits adhere to Rule 12(b)(6) and afford plaintiff the benefit of all reasonable inferences. Indeed, for the elements of fraud other than scienter, all circuits agree that reasonable inferences from complaint allegations must be drawn in plaintiff's favor. *Helwig*, 251 F.3d at 553; *Gompper*, 298 F.3d at 895; *Pirraglia*, 339 F.3d at 1188.

With respect to scienter, the Sixth Circuit in *Helwig* held that, under the PSLRA, in determining whether plaintiff's complaint has sufficiently alleged a "strong inference" that defendants acted with scienter (intent, knowledge, recklessness), plaintiff's allegations "are entitled only to the ***most***

plausible of competing inferences." 251 F.3d at 553 (emphasis added). Petitioners' theory is even more extreme than the position of the Sixth Circuit. They boldly urge that plaintiff's complaint must "exclude the possibility of innocence." (Pet. Br. 17) The Sixth Circuit in *Helwig* rejected that approach: "Inferences must be reasonable and strong—but not irrefutable." 251 F.3d at 553; *accord Cabletron*, 311 F.3d at 38. "Plaintiffs need not foreclose all other characterizations of fact, as the task of weighing contrary accounts is reserved for the fact finder." *Helwig*, 251 F.3d at 553.

Moreover, in *Helwig* and in subsequent cases, the Sixth Circuit has been, to say the least, ambivalent. In *Helwig*, for example, the majority stated: "Contrary to defendants' contention, the Reform Act did not reverse the polarity of securities pleading." *Id.* The court added: "'When an allegation is capable of more than one inference, it must be construed in the plaintiff's favor.'" *Id.* (citation omitted). Indeed, the Court said: "Our willingness to draw inferences in favor of the plaintiff remains unchanged by the PSLRA." *Id.* In a later case, the court backtracked even further: "One might argue that for cases where a juror could conclude that the facts pleaded show scienter, but that conclusion would not be the most plausible of competing inferences, a Seventh Amendment problem is presented." *Bridgestone*, 399 F.3d at 683. The Seventh Circuit agreed. (App. 20a)

In *Gompper*, 298 F.3d at 896-97, the Ninth Circuit rejected plaintiff's argument that where the facts alleged give rise to reasonable inferences of scienter, the court must accept these inferences without considering competing plausible inferences suggested by defendants. *Id.* at 896-97. Believing there was an "inevitable tension" between Rule 12(b)(6) and the PSLRA, the court held that in determining whether plaintiff has sufficiently alleged a "strong inference" of scienter, "the court must consider ***all*** reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs." *Id.* at 897 (emphasis by the court).

In *Gompper*, the court reasoned that, if courts are required to consider only inferences favorable to plaintiffs when there are "equally or more plausible" adverse inferences, it would "eviscerate the PSLRA's strong inference requirement by allowing plaintiffs to plead in a vacuum," and "would allow all plaintiffs who engage in careful measured pleading to demonstrate a strong inference of scienter" that "would thwart Congress's basic purpose in raising the bar in the first place." *Id.* at 896-97. The Ninth Circuit's fears are misplaced. It overlooked the fact that to benefit from the inferences in the first place, or to have them considered collectively, the PSLRA requires that all of plaintiff's scienter allegations be stated with "particularity" and to have a specific "factual basis." 15 U.S.C. §78u-4(b). Thus, the particularity requirement ensures that plaintiffs do not plead in a vacuum. Moreover, contrary to the Ninth Circuit observation, "careful, measured pleading" is precisely what the PSLRA demands and courts should expect.

All other circuits that have engaged in the PSLRA strong inference analysis continue to give plaintiff the benefit of all reasonable inferences as contemplated by Rule 12(b)(6). The First Circuit explained that the PSLRA strong-inference standard does not change the rule that "a court must draw all reasonable inferences in plaintiff's favor" and then weigh them together to determine if "they satisfy" the strong inference standard. *In re Stone & Webster Sec. Lit.*, 414 F.3d 187, 195 (1st Cir. 2005); *accord Cabletron*, 311 F.3d at 28, 38 (Despite the PSLRA "strong inference" standard, the court "continues to give all reasonable inferences to plaintiffs" that, as a "totality" must be strong "but need not be irrefutable").

Contrary to petitioners' assertion (Br. 34-37), the First Circuit did not change its approach in *In re Credit Suisse First Boston Corp.*, 431 F.3d 36 (1st Cir. 2005). There, the court reaffirmed: "In considering a motion to dismiss, the district court is bound to 'assume the truth of all well-pleaded facts and ***indulge all reasonable inferences that fit the***

plaintiff's stated theory of liability.'" *Id.* at 45 (emphasis added). Although *Credit Suisse* observed that there were "legitimate explanations" that are "equally convincing" (*Id.* at 49), such weighing of conflicting explanations is contrary to the First Circuit's earlier holding that it is error to draw "inferences in the defendants' favor." *Aldridge*, 284 F.3d at 79. Because the earlier panel decision states circuit law, and can only be changed *en banc*, *Aldridge* is binding and cannot be overruled by the *Credit Suisse* panel. *See United States v. Malouf*, 466 F.3d 21, 26-27 (1st Cir. 2006).

The Eighth Circuit also expressly rejected *Helwig's* "competing inferences" theory. *In re K-Tel Intern, Inc. Sec. Litig.*, 300 F.3d 881, 889 n.6 (8th Cir. 2002). "The strong inference pleading standard does not license us to resolve disputed facts at this stage of the case." *Green Tree*, 270 F.3d at 666. The Second, Fifth and Eleventh Circuits likewise continue to draw inferences in plaintiff's favor. *Suez Equity Investors L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 100 (2d Cir. 2001); *Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 424-25 (5th Cir. 2001); *Garfield v. NDC Health Corp.*, 466 F.3d 1255, 1261 (11th Cir. 2006). The Third Circuit agrees, but explained that under the PSLRA the plaintiff gets the benefit of reasonable inferences provided the facts in the complaint are alleged with particularity. *Rockefeller*, 311 F.3d at 224.

Similarly, contrary to petitioners' description, the Tenth Circuit declined to draw adverse inferences, and instead took what it termed a "more contextual approach" stating:

> Whether an inference is a strong one cannot be decided in a vacuum. In evaluating the strength of a plaintiff's inference of scienter, we may recognize the possibility of negative inferences that may be drawn against the plaintiff. We do so, not in a preclusive manner, but in an evaluative manner. That is to say, we consider the inference suggested by the plaintiff while acknowledging other possible inferences, to determine whether

> plaintiff's suggested inference is "strong" in light of its overall context.

Pirraglia, 339 F.3d at 1187. Had the Tenth Circuit stopped there, its approach would be at odds with the Rule 12(b)(6) framework requiring consideration of plaintiff's best case. But the Court in *Pirraglia* proceeded to make clear that:

> [T]his process does not involve a 'weighing' of the plaintiff's suggested inferences against other inferences. Faced with two seemingly strong inferences, one favoring plaintiff and one favoring defendant, it is inappropriate for us to make a determination as to which inference will ultimately prevail, lest we invade the traditional role of the fact finder.

Id. at 1188. The Seventh Circuit agreed—correctly. (App. 21a)

Petitioners are also mistaken about the position of the Fourth Circuit, which continues to draw "reasonable inferences in [plaintiff's] favor." *In re PEC Solutions, Inc. Sec. Lit.*, 418 F.3d 379, 387 (4th Cir. 2005). That court takes a "flexible case-specific" approach to pleading with particularity facts giving rise to a strong inference. *Id.*; *Ottmann v. Hanger Orthopedic Group, Inc.*, 353 F.3d 383, 344-45 (5th Cir. 2003).

In sum, with the very limited exceptions of the Sixth and Ninth Circuits, all the others continue to recognize the essential premise of Rule 12(b)(6) and afford plaintiff the benefit of all reasonable inferences in assessing scienter under the PSLRA "strong inference" standard. Under *Liberty Lobby*, the majority view is correct.

III. Contrary to the SEC's Contentions, the PSLRA Does Not Require Courts to Consider Competing Inferences or Explanations; Doing So Would Violate the Right to Jury Trial

Eviscerating entirely the core premise of Rule 12(b)(6), the SEC asserts that in determining a "strong inference" under the PSLRA, courts "must" consider "other possible [non-culpable] explanations" or "any competing inference that can

be drawn." (SEC Br. 24) The SEC's position is wrong under *Liberty Lobby*—a decision the SEC simply ignores.

As discussed earlier, in *Liberty Lobby* this Court explained that in ruling on a dispositive motion, "the judge must view the evidence through the prism of the substantive evidentiary burden." *Liberty Lobby*, 477 U.S. at 254. The court emphasized, however, that the higher standard does not license the weighing of a competing story: "the weighing of evidence and the drawing of legitimate inferences from the facts are jury functions, not those of a judge . . . . The evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his [nonmovant's] favor." *Id.* at 255.

The SEC's theory is at odds with its view that the PSLRA made the then-existing Second Circuit strong inference test into a uniform national standard. (SEC Br. 8, 18) The SEC overlooks that the Second Circuit has been faithful to Rule 12(b)(6) by drawing all reasonable inferences in plaintiff's favor in determining whether a strong inference has been alleged—and did so both before and since the enactment of the PSLRA. *Shields*, 25 F.3d at 1128; *Rombach*, 355 F.3d at 169.

The SEC is also wrong in asserting that when reasonable inferences supporting scienter are matched by equally plausible non-culpable inferences, the ultimate inference of scienter is not strong because there is a "substantial possibility" that defendant acted without scienter. (SEC. Br. 25) When summary judgment evidence—or complaint allegation—and inferences drawn in nonmovant's favor—"may reasonably be resolved in favor of either party," the motion should be denied and the issue must be submitted to a fact finder for trial. *Liberty Lobby*, 477 U.S. at 250.

The SEC *amicus* brief represents a sharp shift in its position. The SEC has in numerous briefs previously stated that the PSLRA adopted the Second Circuit's strong inference test as a national rule. *See, e.g.*, SEC Br. in *Novak v. Kasaks*, No.

98-9641 (2d Cir. 1998) at 1-2. *Novak* is one of the SEC briefs filed between 1997 and 2001, in which the SEC consistently stated that the PSLRA adopted the Second Circuit pleading standard. *See also* SEC Br. in *Nathenson v. Zonagen*, No. 99-20449 (5th Cir. 1999) at 10-15. That standard was considered "the most stringent in the nation." *Novak*, 216 F.3d at 310-11. But even under that standard, both before and since the PSLRA, the Second Circuit draws all reasonable inferences in plaintiffs' favor. *Cohen*, 25 F.3d at 1174; *Rombach*, 355 F.3d at 169.

The SEC now seeks to distort the usual inference-drawing practice under Rule 12(b)(6) by calling for a judicial amendment rather than formal rulemaking, urging that courts "must consider competing inferences and non-culpable explanations for the defendant's conduct"—at the pleading stage. (SEC Br. 8-9, 20-21, 24-26) First, the SEC's approach is contrary to *Jones v. Bock*, which held Federal Rules practice can only be changed by amending the rules. 127 S.Ct. 910 at *25. Second, when the SEC changes position, this Court has not accorded it deference. *Int'l Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 566 n.20 (1979) (collecting cases); *see also American Federation v. American Intern.*, 462 F.3d 121, 129 (2d Cir. 2006). This Court should not defer to the SEC here because to do so would be contrary to the SEC's long-standing position—to which it now only pays lip-service—that "meritorious private actions are an essential supplement" to government enforcement, presumably for the protection of investors. (SEC Br. 1) But, "[s]etting the pleading threshold too high" by accepting the SEC position would "bar meritorious claims," and make it virtually impossible to plead securities fraud and violate Rule 12(b)(6).

A. The Strong Inference Standard Does Not License Trial by Complaint

Petitioners go even further and contend the Court "should consider and weigh" not only the allegations of the complaint,

but also "facts that support an inference of innocence" including "other facts properly before [it]." (Pet. Br. 17)

A motion to dismiss is not the stage of proceedings to consider evidence, let alone asserted facts outside the complaint. When evidence outside the complaint is offered, the motion to dismiss must be converted into one for summary judgment. Fed. R. Civ. P. 12(b). Although judicial notice of "undisputed facts" is permitted in connection with a Rule 12(b)(6) motion, courts cannot accept the truth of "disputed facts." *Lee v. City of Los Angeles*, 250 F.3d 668, 688-90 (9th Cir. 2001). Even for documents filed with the SEC, judicial notice is limited to determining what "the . . . documents contain, not to prove the truth of the documents contents." *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1275-77 (11th Cir. 1999). Congress recognized that filing a document with the SEC does not mean it is "true" and, indeed, may be "false or misleading." 15 U.S.C. §78z.

Petitioners cite *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587-88 (1986), where they say that this Court in an antitrust price-fixing case held that courts may consider and weigh competing inferences from evidence submitted on summary judgment. (Pet. Br. 30-31) *Matsushita* is not pertinent here. That decision addresses a unique concern in price-fixing cases that lawful conduct that encourages competition could be misconstrued as collusive, because "cutting prices to increase business often is the very essence of competition" which "antitrust laws are designed to protect." *Matsushita* at 593-94. There is no comparable concern here. Securities laws are designed to protect investors from deceptive conduct, and there is little or no danger that accounting manipulation, false financial projections, or active concealment of a company's financial problems would be misconstrued as legitimate conduct.

This Court has subsequently explained that *Matsushita* is limited to cases where the evidence consists only of *prima facie* legitimate and pro-competitive conduct, and, "in that

context," the inference of antitrust conspiracy was "speculative" and not "reasonable." *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 468 (1992). This Court reiterated in *Eastman Kodak*, citing *Liberty Lobby*, that "all justifiable inferences are to be drawn in [plaintiff's] favor." *Id.* at 456. Doubtless recognizing that *Matsushita* is inapposite here, the SEC never mentions it.

Petitioners also contend that the absence of allegations can be considered, particularly the absence of "economic motive" to commit fraud. (Pet. Br. 17) In fact, the absence of certain categories of allegations is "not decisive." *Cabletron*, 311 F.3d at 32. "Sufficient evidence of one type might reduce or eliminate the need for evidence in other categories, without thwarting the legislative intent behind the PSLRA." *Id.*; *see also Illinois v. Gates*, 462 U.S. 213, 238 (1983) (holding a deficiency in one element of probable cause can be offset by a strong showing as to the other element). The absence of motive cannot trump pleading of a strong inference based, for example, on defendants' admissions of fraud, or on witness and document sources.

When the inferences of culpability, viewed collectively, allow rational jurors to find a strong inference, even though there are seemingly plausible inferences to the contrary, Rule 12(b)(6) requires that a motion to dismiss be denied, and deferred to a jury for resolution.

B. Applying *Liberty Lobby* by Drawing All Reasonable Inferences in Plaintiffs' Favor Avoids Intrusion on the Right to Jury Trial

The SEC misconceives the issue when it asserts that the "strong inference" standard does not raise Seventh Amendment concerns. (SEC Br. 26-29) The constitutional issue is not presented by the Congressional standard, but by the government's assertion that judges deciding a Rule 12(b)(6) motion "must consider any competing inferences and nonculpable explanations." (SEC Br. 24) As discussed above,

under Rule 12(b)(6), the judge does not consider defendant's explanations or inferences—the jury does. If the totality of facts alleged and reasonable inferences drawn support a strong inference of conscious fraud, plaintiff is entitled to a jury trial. *Liberty Lobby*, 477 U.S. at 255.

The cases cited by the SEC hold that the right to a jury trial presents no obstacle to directed verdict or summary judgment because a determination had been made that the nonmovant did not have a triable case as a matter of law—but only after viewing the evidence in the nonmovant's favor. "'No one is entitled in a civil case to trial by jury unless and except so far as there are issues of fact to be determined.'" *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 336 (1979); citing *Ex Parte Peterson*, 253 U.S. 300, 310 (1920). But summary judgment will not lie if the dispute about a material fact is "genuine," that is when "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Liberty Lobby*, 477 U.S. at 248. The "judge's function is not himself to weigh" the evidence or inferences, but only to determine whether they "***may reasonably be resolved in favor of either party***." *Id.* at 249-50 (emphasis added).

As noted above, these principles were drawn from the common law demurrer, as succinctly explained by Chief Justice Marshall in 1808: "The party demurring admits the truth of the testimony to which he demurs . . . and such conclusions [inferences of fact] as a jury might justifiably draw [in plaintiff's favor] the court ought to draw." *Pawling*, 8 U.S. [4 Cranch] at 221-22. Thus, allowing a judge charged with deciding a dispositive motion, as a matter of law, to become a fact finder who can weigh competing inferences and explanations would invade the right to a jury trial.

In sum, drawing inferences in plaintiffs' favor on a dispositive motion is not simply one of the "procedural incidents" of jury trial (*e.g.*, a court's exclusion of "evidence for irrelevancy"), but one of "its most fundamental elements" because such inference-drawing is dispositive of whether there

are issues of fact for a jury. *Galloway v. United States*, 319 U.S. 372, 389-90, 392, (1943). When a court ruling on a dispositive motion weighs competing inferences and "fails to draw all reasonable inferences in favor of [plaintiff]," it acts as a fact finder and "impermissibly substitute[s] its judgment concerning the weight of the evidence for the jury's." *Reeves*, 530 U.S. at 153. The Seventh Amendment ensures "that the ultimate determination of issues of fact by the jury be not interfered with." *Peterson*, 253 U.S. at 310. Applying *Liberty Lobby* and *Reeves* here—by drawing inferences in plaintiffs' favor—avoids any Seventh Amendment issue.

IV. This Court Should Reaffirm the Majority Rule that Plaintiff Is Entitled to All Reasonable Inferences Tested as a Totality Against the "Strong Inference" Standard; Allowing Inferences Adverse to Plaintiff Violates Rule 12(b)(6), and Would Seriously Impair Investor Recovery for Corporate Fraud

Setting aside the hyperbole of petitioners and their *amici* who dwell on abuses reported in some securities actions prior to the 1995 enactment of the PSLRA, this case arises against a very different factual landscape. For the past five years—the Enron era—our markets have suffered an unprecedented number of corporate accounting scandals causing $7 trillion in losses to investors and retirees. Millions of Americans have watched their entire retirement income disappear. But securities fraud is not confined to huge scandals like Enron. There are many small and medium size frauds that have caused investors, including public pension funds whose middle class members can ill afford the loss of their entire retirement savings, to suffer substantial injury. When corporate insiders manipulate the market, often with the complicity of banks, accountants and lawyers, courts should be cautious not to raise the bar of the PSLRA any higher than its already heightened standards—requiring particularity, a factual basis and a strong inference. 15 U.S.C. §78u-4(b).

Petitioners' adverse inference theory endorses trial on the complaint—without evidence. That approach would produce needless confusion and inconsistency. Congress did not contemplate such a far-reaching change in long-standing pleading practice. "The PSLRA did not . . . purport to move up the trial to the pleading stage." *Adams*, 340 F.3d at 1101.

Petitioners' approach sends the wrong message at the wrong time. "Unless reasonable inferences from circumstances suffice to get a case to a jury, the welfare of victimized investors and the integrity of the stock market may be insufficiently protected from deceptive manipulations." *Ronconi*, 253 F.3d at 428. The PSLRA "was not enacted to raise the pleading burdens" to a level that "facially valid claims" must be "routinely dismissed on Rule 9(b) and 12(b)(6) motions." *ABC Arbitrage*, 291 F.3d at 354; *accord Cabletron*, 311 F.3d at 30.

The Grundfest *amici* seek to narrow the scope of the private cause of action in securities fraud even beyond the limits imposed by Congress in the PSLRA. (Grundfest Br. 4) In the process, they ignore and appear willing to undermine longstanding Rule 12(b)(6) jurisprudence. They also ignore entirely the teaching of *Liberty Lobby* that, despite a heightened standard, in ruling on a dispositive motion, "all justifiable inferences are to be drawn in [plaintiff's] favor." 477 U.S. at 255. Contrary to Grundfest's assertion (Br. 4), weighing and comparison of possible competing inferences from the facts "are jury functions, ***not those of a judge***." *Id.* (emphasis added). Grundfest never mentions *Liberty Lobby*, worse yet, there is no mention of Rule 12(b)(6). Grundfest, like other *amici*, discuss *ad nauseum* asserted pleading abuses that led to the PSLRA. (*Id.* at 12-16) They simply refuse to face the reality that securities actions today are fewer and better—and both better led and better pled by institutional investors like the *amici* on this brief.

This Court's decision in *Huddleston* further contradicts *amici's* theories. The Court reversed a Court of Appeals

ruling that plaintiffs must prove a §10(b) claim by clear and convincing evidence, and held that a preponderance of the evidence suffices. 459 U.S. at 387-91. The Court reasoned that "[a]ny other standard expresses a preference for one side's interests." *Id.* at 390. The Court recognized that "the interests of plaintiffs in such suits are significant. Defrauded investors are among the very individuals Congress sought to protect in the securities laws." *Id.* This Court emphasized that the "existence of [a private §10(b) action] is simply beyond peradventure." *Id.* at 380. Indeed, Congress codified such actions in the PSLRA. 15 U.S.C. §78u-4(a)(1).

Congress adopted the strong inference standard to deter pleading abuses, not to do away with private suits entirely—which a rule allowing the weighing of competing inferences could bring about. In enacting the PSLRA, Congress made clear that: "Private securities litigation is an ***indispensable tool*** with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs." H.R. Conf. Rep. 104-369 at *31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730.

In sum, this Court should reaffirm the majority rule that, despite the heightened standard in the PSLRA, Rule 12(b)(6) still requires that the court consider whether plaintiff's best case, drawing all inferences in plaintiff's favor and considered as a "totality," raises a "strong inference" of scienter.

CONCLUSION

The Court should affirm the holding of the Seventh Circuit that on a motion to dismiss, plaintiff is entitled to all reasonable inferences from well-pled facts.

Respectfully submitted,

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